

**SALES AND USE TAX REVIEW COMMISSION
RECOMMENDATION PURSUANT TO P.L. 1999, C. 416**

BILL NUMBER:

A-58

DATE OF INTRODUCTION:

January 8, 2002

SPONSOR:

Assemblyman Smith
Assemblywoman Coleman

DATE OF RECOMMENDATION:

March 26, 2002

IDENTICAL BILL:

COMMITTEE:

Assembly Commerce and Economic Development

DESCRIPTION:

The Bill amends and supplements the New Jersey Urban Enterprise Zones Act, N.J.S.A. 52:27H-60 et. seq. to provide that enterprise zones may be designated as permanent zones under certain conditions relating to unemployment statistics. The Bill also expands the reduced sales tax rate to include restaurant meals, provides for local decision making on investing monies received from the reduced tax collections, and lessens the restrictions on allowing zone businesses to use investment of capital instead of hiring people in order to become qualified under the Urban Enterprise Zone program.

ANALYSIS:

This Bill is proposed to amend the Urban Enterprise Zones Act, N.J.S.A. 52:27H-60, et. seq., to allow certain enterprise zones to be designated as permanent zones. It also expands the reduced sales tax rate to include restaurant meals, provides for local decision making on investing monies received from the reduced tax collections, and lessens the restrictions on allowing zone businesses to use investment of capital instead of hiring people in order to become qualified under the Urban Enterprise Zone program.

The section of the Bill permitting businesses to invest capital instead of hiring employees defeats the purpose of the program as originally intended. The Urban Enterprise Zone program was originally based on the premise that benefits should be available if businesses hire unemployed persons, thereby stimulating economic activity in distressed areas of the state. The extension of the program to grant benefits to those businesses who simply invest capital instead of hiring unemployed people seems to be a deviation from the original goal of the legislation. While investing capital may be of benefit to the individual business and municipality, hiring out of work people in order to reduce the level of unemployment in these distressed areas is the avowed purpose of the Urban Enterprise Zone program. In addition, the easier it is for certain businesses to qualify for charging 3% sales tax, the more that competitors located outside a zone will assert that the Urban Enterprise Zone program gives an unfair advantage to businesses in the zone. The Bill could also result in a trend toward more "automatic" qualification for urban enterprise zone benefits.

The provision in the Bill allowing the municipality to make its own independent investment decisions with its own designees may result in some unforeseen problems. Since the funds under the program are derived from state taxes, it appears that investment agreements should be monitored and controlled at the state level.

Further, the Bill states that the Urban Enterprise Zone Authority must notify qualified businesses that the Urban Enterprise Zone benefits have been extended and will continue for as long as the zone retains its designation. Qualified businesses must ordinarily requalify every year. The Bill is vague in terms of allowing qualified businesses in the permanent zones to receive Urban Enterprise Zone benefits without annual requalification. The proposal also fails to consider the situation of new businesses qualifying in the permanent zones since the definition of a qualified business is not amended to refer to permanent zones.

The portion of the bill permitting urban enterprise zone qualified businesses to charge 3% sales tax on “retail sales by restaurants of meals and non-alcoholic beverages ...” creates multiple problems. First, N.J.S.A. 54:32B-3(c) imposes tax on sales by “restaurants, taverns, vending machines or other establishments ...or by caterers, including ...any cover ...charge.” Since the Bill only refers to “restaurants,” owners of taverns, vending machines and caterers will be upset if they must continue to charge 6% sales tax. Thus, this exemption benefits a specialized group and does not promote horizontal equity. Horizontal equity mandates that sales tax legislation be broadly based and taxes similar transactions, persons or things in a similar manner. Tax treatment should be uniform from one taxpayer to another. By only providing an exemption to a specific group, the proposal creates a disparity between restaurant owners and owners of taverns, vending machines and caterers that are presumably not included in the exemption. Thus, the vendors excluded by the Bill who must continue to charge 6% sales tax may complain that the Bill violates the concept of horizontal equity by giving a benefit to a similarly situated group.

Second, the rationale behind the Bill is unclear. Presumably it is to encourage consumers to enter the urban enterprise zone by offering a 3% reduction on restaurant meals, thereby inducing buyers to make more purchases than they would if the sales tax rate was 6%. But it is doubtful that a consumer would be enticed into an urban enterprise zone by the prospect of reduced sales tax on a meal and then make substantially more purchases simply because the sales tax rate is 3%.

The third problem associated with allowing restaurants to charge 3% on meals results from the fact that the proposal does not include alcoholic beverages in the partial exemption. This aspect may lead to costly errors because the restaurant employees will need to itemize alcoholic beverages separately from non-alcoholic beverages and from

meals. If the restaurant erroneously charges 3% sales tax on the alcoholic beverages, it will be subject to assessments for the remaining 3% sales tax, plus penalties and interest. The need to separately itemize alcoholic beverages from non-alcoholic beverages and meals might outweigh the benefit conferred due to the inconvenience and expense of separate accounting.

The current program for reduced sales tax deals only with sales of tangible personal property. Services to property are not part of the exemption. Including restaurant meals in the partial exemption may create a slippery slope because vendors located within the urban enterprise zones who provide other services may be lead to also seek a similar tax exemption.

The loss of revenue to the State would be substantial because the 3% sales tax collected would be remitted to the municipality in which the urban enterprise zone is located and not to the State's General Fund. Thus, the State would lose the entire 6% sales tax that is currently collected on restaurant meals.

Finally, varying tax rates from municipality to municipality threatens economic neutrality and horizontal equity within the State. The doctrine of economic neutrality promotes a system of taxation that has a limited effect or impact on the marketplace and avoids policy that benefits one segment of the market at the expense of another. The goal, upon which the Urban Enterprise Zones Act is based, is to bring new businesses and consumers to selected economically depressed areas. In doing this, the surrounding municipalities from which business and consumers are drawn suffer negative economic effects. Horizontal equity refers to the concept that tax treatment should be uniform from one transaction to another. The Act creates a lower sales tax rate for sales of restaurant meals within the zones. This disparate treatment of certain transactions violates this doctrine. Adding more types of sales under the purview of the 3% sales tax rate would exacerbate the already tenuous foundation upon which the Act is based.

RECOMMENDATION:

The Commission does not recommend enactment of this Bill.

COMMISSION MEMBERS FOR PROPOSAL: 0

COMMISSION MEMBERS AGAINST PROPOSAL: 4

COMMISSION MEMBERS ABSTAINING: 1

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